

APSKAITOS IR FINANSŲ MOKSLAS IR STUDIJOS: PROBLEMOS IR PERSPEKTYVOS
SCIENCE AND STUDIES OF ACCOUNTING AND FINANCE: PROBLEMS AND PERSPECTIVES

eISSN 2351-5597. 2019, vol. 13, no 1: 12-18

Article DOI: <https://doi.org/10.15544/ssaf.2019.02>**TAX AUTHORITY IMPACT ON COMPANY'S LIQUIDATION
(LATVIAN EXAMPLE)****Laila Kelmere***Latvia University of Life Sciences and Technologies, Latvia***Abstract**

The role of the state in regulating the business environment is high and there are situations where the state must promote the suspension of the company's business and liquidation of the company, if it results in the improvement of the business environment. The research aim is to analyze the State Revenue Service (SRS) impact on taxpayer's business directly or partly directly by using enactments and as a result the impact on the company's liquidation.

The author compiled statistics from the SRS public reports about the SRS activities to put the business environment in order and promote fair competition in business using tools for taxpayer operation-restricting measures. And also schematically presented the provisions of the regulatory enactments regarding the suspension and renewal of the taxpayer's economic activity, as well as exclusion from the Register of Enterprises in case if the violation does not relate to the employment of employees without a contract.

Used methods: the monographic method, statistical methods, logical analysis and synthesis, the graphics method, the logical and constructive methods were used in analyzing results and making judgments.

The present research used the author's previously made research, the Latvian enactments The Commercial Law and The Law on Taxes and Duties, the annual reports of the State Revenue Service of the Republic of Latvia and their statistics.

Starting from 2013 in the average for 11073 taxpayers per year the SRS suspend their economic activity. Started from 2014 the SRS terminated the taxpayer activity in 29321 cases and from this amount the 27076 taxpayers were registered in the Register of Enterprises and mostly are limited liability companies.

According to the statistical data author concludes that SRS is very active to put the business environment in order and it affects on the number of excluded entities from Registers of Enterprises too. During 2012 – 2017 were registered 83121 entities and excluded 53645 entities in the Register of Enterprises, and in the same time of period (2012 – 2017), SRS suspended 50335 taxpayer's economic activities but renewing the economic activities only 4.93% of them.

Keywords: business environment, government role, tax administration, entrepreneurship, taxpayer.

JEL Codes: G38, H26, M48.

Introduction

It is generally more beneficial for creditors and the state as a whole if the company is liquidated under the usual procedure, i.e., it fully covers its obligations towards creditors and then is liquidated. However, in reality, various economic crises introduced some changes, as a result of which the companies often eliminate using the opportunities of the insolvency proceedings. Such behavior psychologically affects both the legislator - using enactments more strengthen the control of the business environment and the entrepreneurs themselves - that promotes a reduction in the level of trust with the cooperation partners. The role of the state in regulating the business environment is high and there are situations where the state must promote the suspension of the company's business and liquidation of the company, if it results in the improvement of the business environment, for example, when an entrepreneur carries out unauthorized activities and does not cooperate in order to eliminate them.

The research aim is to analyze the State Revenue Service (SRS) impact on taxpayer's business directly or partly directly by using enactments and as a result the impact on the company's liquidation.

The direct impact is manifested as the right to terminate the taxpayer economic activities and give the information to the LR Register of Enterprises for making a decision on exclusion from the Commercial Register.

The partly direct impact is manifested as the right to exclude taxpayer from the Value-added tax (VAT) Payer Register, suspend the taxpayer's economic activity or to impose the additional fine, namely, deprivation of the right to take certain positions in commercial companies.

The author compiled statistics from the SRS public reports about the SRS activities to put the business environment in order and promote fair competition in business using tools for taxpayer operation-restricting measures. And also the author schematically presented the provisions of the regulatory enactments regarding the suspension and renewal of the taxpayer's economic activity, as well as exclusion from the Register of Enterprises in case if the violation does not relate to the employment of employees without a contract.

Materials and Methods

The following qualitative and quantitative methods were employed: the monographic method – in examining, assessing and analysing literature and enactments, selecting only the information related to the present research, describing findings and interpretations; statistical methods, i.e. statistical observation, compilation and grouping of information, calculation of statistical data, analysis of causal relationships and data generalisation; logical analysis and synthesis. The graphics method was employed to show the relationships identified and their nature and form. The logical and constructive methods were used in analyzing results and making judgments.

The present research used the author's previously made research, the Latvian enactments The Commercial Law and The Law on Taxes and Duties, the annual reports of the State Revenue Service of the Republic of Latvia and their statistics.

Research Results and Discussion

Each country determines its own procedures for registering economic activities and establishing a company, and in what order suspends economic activities and liquidate of the company. It is generally more beneficial for creditors and the state as a whole if the company is liquidated under the usual procedure, i.e., it fully covers its obligations towards creditors and then is liquidated. However, in reality, various economic crises introduced some changes, as a result of which the companies often eliminate using the opportunities of the insolvency proceedings. Such behavior psychologically affects both the legislator - using enactments more strengthen the control of the business environment and the entrepreneurs themselves - that promotes a reduction in the level of trust with the cooperation partners. The role of the state in regulating the business environment is high and there are situations where the state must promote the suspension of the company's business and liquidation of the company, if it results in the improvement of the business environment, for example, when an entrepreneur carries out unauthorized activities and does not cooperate in order to eliminate them.

Latvian law determines voluntary and compulsory capital company termination.

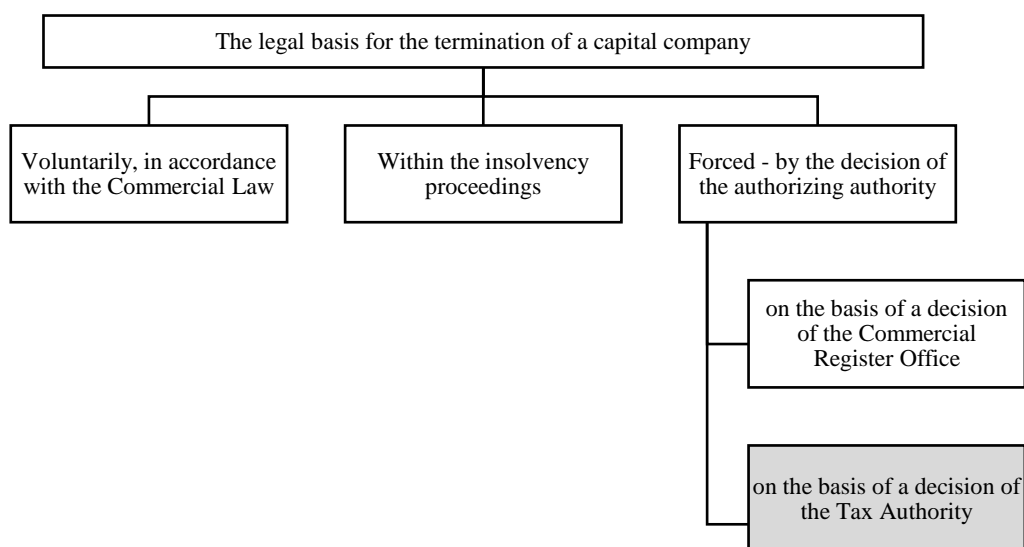


Figure 1. The Legal Basis for the Termination of a Capital Company in Latvia.

(Source: authors' construction based on Parliament of the Republic... (2000))

In Latvia, after the restoration of independence, the regulatory framework already contained a simple provision that the SRS could suspend the company's economic activities.

Started from 5 July 1996 the SRS has the right to suspend the taxpayer's economic activities due to infringements of laws and regulations. From 4 March 2008 in this case the SRS must send information on the suspension of economic activity of the taxpayer to the Register of Enterprises if the economic activity of the taxpayer registered in the register of the Enterprise Register or Commercial Register is suspended and also send the information on reinstating of the taxpayer's economic activity if SRS renewing the suspended economic activity of a taxpayer.

The 2007-2008 economic crisis had a significant impact on business in Latvia, unemployment was rising rapidly and tax revenues decreased.

To motivate individuals to engage in entrepreneurship in Latvia in 2010:

- 1) essential amendments were made in the Commercial Law;
- 2) was developed and adopted the Micro-enterprise Tax Law.

Started from 1 May 2010 the initial registered and paid-in equity capital for a limited liability company (hereinafter - LLS) could be 1.42 EUR and after Latvia's accession to the European Union – 1 EUR. Before these changes, if founding an LLC, an equity capital of 2845.74 euros had to be paid in before applying to the Register of Enterprises. (Parliament of the Republic..., 2000)

Started from 1 September 2010 the Micro-enterprise Tax Law takes effect. The micro-enterprise tax rate was set at 9% of the calendar year's turnover (till 2012) and the status of a micro-enterprise could be obtained voluntarily by an individual merchant, an individual undertaking, a farm or fishing enterprise, as well as a natural person registered with the State Revenue Service as a performer of economic activity or a limited liability company which meets the following criteria:

- 1) the participants (if any) are natural persons, members of the board of directors of a limited liability company may only be employees of the micro-enterprise,
- 2) the turnover does not exceed 99 601 *euros* in a calendar year,
- 3) the number of employees does not exceed five at any time and the remuneration for work at a micro enterprise does not exceed 711.44 *euros* per month (Parliament of the Republic..., 2010).

Šneidere and Būmane welcomes the changes made to the Commercial Law, which allows the creation of new ones LLC with a minimum share capital of 1 EUR. As per their research for the first four years, 66.3% of all start-up companies have benefited from the Commercial Law, while their share has declined to 60.7% in the last year, but it also shows the high activity of entrepreneurs, as 30% of founders are newcomers who have not been involved in business as officials or members (Šneidere and Būmane, 2016).

And Leibus thinks that the micro-enterprise tax is a successful fiscal instrument to support small business during the economic crisis, particularly in the countries with high labour costs. Although the influence of the micro-enterprise tax on the economy is small, its introduction was a successful strategy. It has encouraged the legalization of business activities that are especially important in the situation of high unemployment. Besides the micro-enterprise tax legalized many physical persons that are now registered as micro-enterprise employees, but previously they were not entered in the taxpayers' data basis (Leibus, 2012).

By creating micro-enterprise tax and reducing the registered and paid-up share capital for LLC government achieved its goal – activating entrepreneurship and increasing the number of entrepreneurs (Table 1).

Table 1. Registration and Removal Dynamics per Year by Latvia's Register of Enterprises in the Period from 2007 till 2012

Year	Number of registered entities	Chain increase, %	Number of excluded entities	Chain increase, %
2007	14208	-	11185	-
2008	11347	-20	4765	-57
2009	9228	-19	5715	20
2010	13422	45	8834	55
2011	18044	34	3920	-56
2012	16891	-6	4308	10

(Source: author's calculations based on statistical data of the Register of Enterprises of the Republic of Latvia¹)

Although the increase in the number of registered companies and taxpayers has also resulted in an increase in tax revenues over the period from, however, the crisis has had a significant impact on the ability of the SRS to collect taxes according to declared information by entities (tax declarations).

Torgler analyzed tax morale in 10 Eastern European countries that joined the European Union in 2004 or 2007 (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia, Bulgaria and Romania). Torgler finds out that tax morale between 2000 and 2008 has decreased in 7 out of 10 countries (Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, and Slovakia) and is consistent with the tax morale values in the 1990s (Torgler, 2012).

This is because, when Latvia moved from a planned economy to a market economy, entrepreneurs were not able to rapidly change their thinking and understand exactly how their actions, including tax evasion or tax avoidance, directly affect the development of the country and the individual development of each individual.

Therefore In 2012 essential amendments were made in the Commercial Law and in the Law on Taxes and Duties – the requirements of both regulatory enactments were aligned:

- 1) the Law on Taxes and Duties strengthened SRS power to suspend and to renew the economic activity of a taxpayer due to infringements of laws and regulations and
- 2) in the Commercial Law was included regulation about the termination of activities of the company on the basis of a decision of the Commercial Register Office or Tax Authority.

The SRS has the right to suspend the economic activity of the taxpayer (or its structural unit in which infringement has occurred) if at least one of the following infringements is identified:

- 1) if the taxpayer employs persons without concluding employment contracts with them, and the proportion of such persons is 50 per cent or more however not less than three persons of the persons employed in the object which is audited (territories and premises owned or used by the taxpayer in which economic activity is performed or which are related to deriving of income in the territory of premises owned or used by other natural or legal person);
- 2) the taxpayer has evaded taxes or duties;
- 3) the taxpayer uses a cash register, hybrid cash register, cash-office system, dedicated device and equipment software or accounting information computer system, the software of which has been changed or other activities have been carried out thereby creating an opportunity to conceal or reduce the taxable base on which taxes and duties are levied;

¹ Register of Enterprises of the Republic of Latvia. Registration and removal dynamics, statistical data 2007-2012. Available at <<https://www.ur.gov.lv/en/statistics/>>.

- 4) the taxpayer disburses income which is not recorded in the accounting registers and in the report on mandatory national social security contributions, personal income tax levied on earnings of employees and State fee of the business risk for the reporting month submitted to the SRS to the person employed, or employs more than one person without concluding employment contracts;
- 5) the taxpayer has not eliminated the infringements which caused its removal from the register of value added tax payers of the SRS;
- 6) the taxpayer has not settled late tax payments subject to recovery based on a decision regarding recovery of late tax payments and a statement regarding the impossibility of recovery is at the disposal of the SRS;
- 7) the taxpayer has not settled late tax payments subject to recovery based on a decision on the recovery of late tax payments and the act on the impossibility of recovery is at the disposal of the State Revenue Service (Parliament of the Republic..., 1995).

According to right given to the SRS, the SRS can impact on company's business directly or partly directly.

The direct impact is manifested as the right to terminate the taxpayer economic activities and give the information to the LR Register of Enterprises for making a decision on exclusion from the Commercial Register.

The partly direct impact is manifested as the right to exclude taxpayer from the VAT Payer Register, suspend the taxpayer's economic activity or to impose the additional fine, namely, deprivation of the right to take certain positions in commercial companies.

The author compiled statistics from the SRS public reports about the SRS activities to put the business environment in order and promote fair competition in business using tools for taxpayer operation-restricting measures (Table 2).

Table 2. The State Revenue Service Measures for Restricting the Business Activities of Taxpayers in the Period from 2012 till 2016

	Type of decision	Unit	Year				
			2012	2013	2014	2015	2016
1	Decision on the suspension of the taxpayer economic activities		637	10351	10905	12545	10492
2	Decision on the termination of the taxpayer economic activities	Number of taxpayers	-	-	11939	8602	8780
2.1	From them - sent information to the LR Register of Enterprises for making a decision on exclusion from the Commercial Register for terminating economic activities		-	-	9981	8703	8392
3	Additional fine, namely, deprivation of the right to take certain positions in commercial companies	Board members of commercial companies	-	1004	1910	1608	1180

(Source: authors' calculations based on annual reports of the State Revenue Service... (2012, 2013, 2014, 2015, 2016))

Starting from 2013 in the average for 11073 taxpayers per year the SRS suspend their economic activity. Started from 2014 the SRS used the given right and terminated the taxpayer activity in 29321 cases and from this amount the 27076 taxpayers were registered in the Register of Enterprises and mostly are limited liability companies.

In order to better understand the importance of these data, it is necessary to look at the total number of taxpayers in each year. As per SRS statistical data the total number of taxpayers (includes both – the legal and the natural persons) on the January 1 of each year are such: in 2012 – 279924 taxpayers, in 2013 – 304861 taxpayers, in 2014 – 330395 taxpayers, in 2015 – 345255 taxpayers and in 2016 – 350924 taxpayers.

In 2012 the SRS decision on the suspensions of the taxpayer's economic activities was in 637 cases or the 0.23% of the total number of taxpayers in this year. In 2013 the SRS decision on the suspensions of the taxpayer's economic activities was for 3.40%, in 2014 – 3.30%, in 2015 – 3.63% and in 2016 – 2.99% of the total number of taxpayers in each particular year. In average it is 2.71% per year. It probably doesn't look so big in numbers if we analyze in percentage terms, but it has a very big psychological impact on taxpayers. Taxpayers tend to feel that the SRS has a significant impact on their business.

The regulatory framework gives the SRS possibility to inform the taxpayer about the possibility of suspension the taxpayer's economic activity. If the SRS warns the taxpayer of suspending its economic activity or has already suspended economic activity, the taxpayer has the opportunity to prevent irregularities and restore economic activity within a certain period of time.

The author schematically presented the provisions of the regulatory enactments regarding the suspension and renewal of the taxpayer's economic activity, as well as exclusion from the Register of Enterprises in case if the violation does not relate to the employment of employees without a contract (Figure 2).

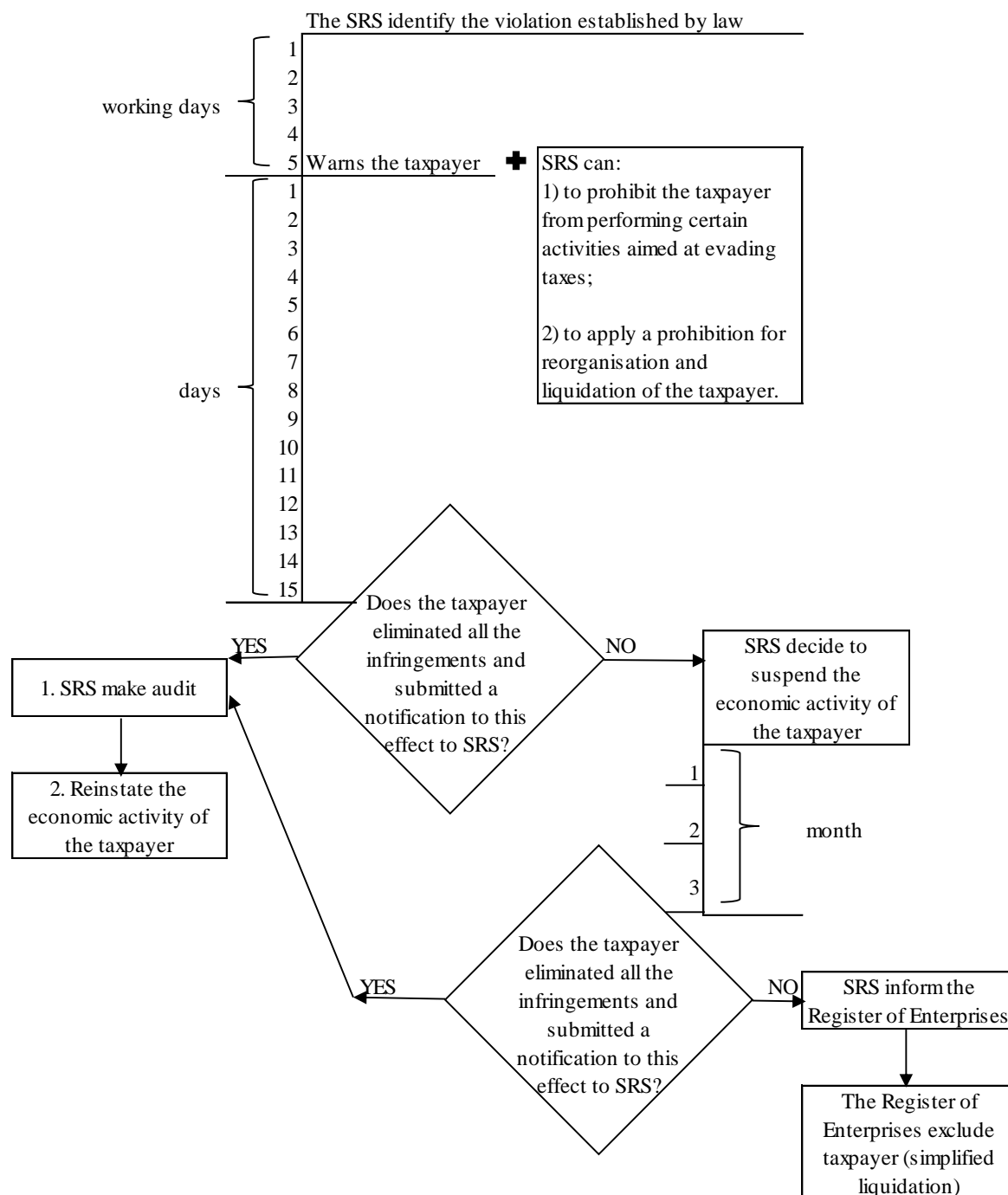


Figure 2. Suspension and Renewal of the Taxpayer's Economic Activity by the State Revenue Service According to Enactments in Latvia

(Source: authors' construction based on The Parliament of the Republic... (1995, 2000))

The SRS has the right to suspend the economic activity of the taxpayer (or its structural unit in which violation has occurred) if at least one of the violations established by an enactment is found. If the violation does not relate to the employment of employees without a contract, the SRS within five working days of identifying the violation, notify the taxpayer of the suspension of its economic activity.

When warning the taxpayer of the suspension of economic activity, the SRS has the right:

- 1) to prohibit the taxpayer from performing certain activities aimed at evading taxes;
- 2) to apply a prohibition for reorganisation and liquidation of the taxpayer (Parliament of the Republic..., 1995).

The taxpayer has 15 days to eliminate all the infringements and inform about it the SRS as the SRS shall take the decision to suspend the economic activity of the taxpayer within 15 days of the notification to this effect in writing if the taxpayer has not eliminated the infringements indicated therein.

If the taxpayer has eliminated all the infringements and has submitted a notification to this effect, the SRS make an audit and, if all is correct, reinstate the economic activity of the taxpayer within one working day.

If the taxpayer did not eliminate all the infringements and the SRS decided to suspend the economic activity of this taxpayer, the SRS within three working days send details on the suspension of economic activity of the taxpayer to the Enterprise Register if the economic activity of the taxpayer registered in the register of the Enterprise Register or Commercial Register are suspended.

And then started three month period – one more given time for the taxpayer to eliminate the infringements.

After three months the SRS checked – do the taxpayer eliminated the infringements or not. If not, the SRS inform about this situation the Register of Enterprises and the Register of Enterprises on the basis of a decision of the Tax Authority exclude this taxpayer from the Enterprise Register or Commercial Register.

This arrangement enables the taxpayer to remedy the deficiencies and restore the economic activity. But at the same time, this system can also be used for other purposes, for example, it can simplify the elimination of a business that could be beneficial in cases where a company has high liabilities to creditors and in this case, the company can avoid insolvency proceeding.

The author compiled statistics about suspension and renewing the economic activities of taxpayers per year by SRS (Figure 3).

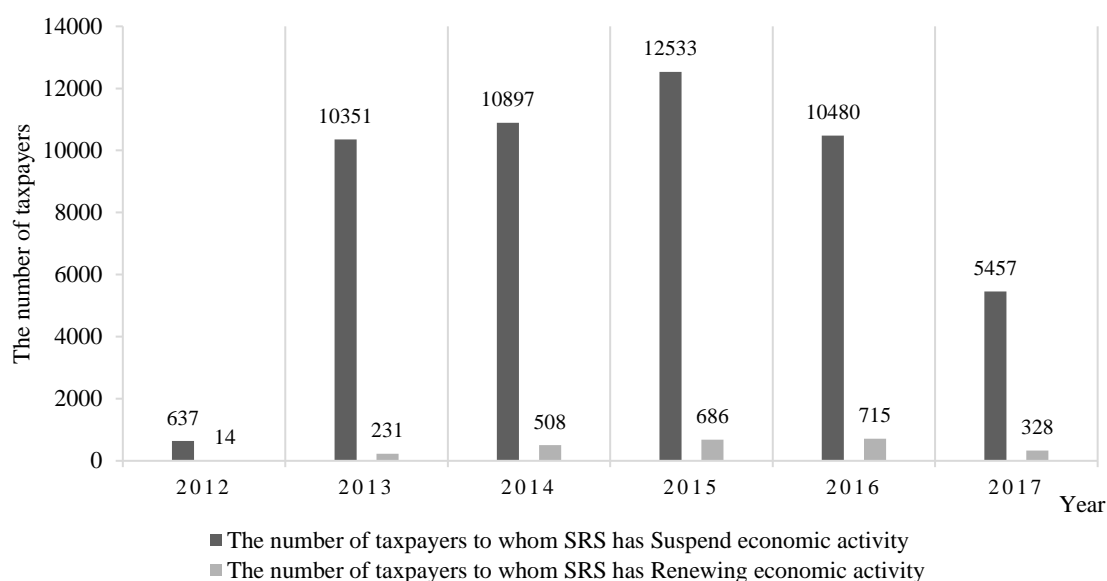


Figure 3. Suspension and Renewing Economic Activity of Taxpayers per Year by the State Revenue Service of the Republic of Latvia in the Period from 2012 till 2017

(Source: authors' calculations based on statistical data of the State Revenue Service of the Republic of Latvia, 2012-2017²)

In the Figure 3 the number of taxpayers includes both – the natural persons registered with the SRS as a performer of economic activity and the taxpayers registered in the register of the Enterprise Register, like limited liability companies.

According to the statistical data author concludes that SRS is very active to put the business environment in order and it affects on the number of excluded entities from Latvia's Registers of Enterprises too. During 2012 – 2017 were registered 83121 entities and excluded 53645 entities in the Register of Enterprises (Kelmere, 2018). And according to the statistical data, in the same time of period (2012 – 2017), SRS suspended 50335 taxpayer's economic activities but renewing the economic activities only 4.93% of them.

Analyzing data of suspensions and renewing economic activity of taxpayers the author believes that the big part of the entrepreneurs do not seek to restore the company's business activities if it has been suspended by the SRS but is waiting for statutory deadlines and expects the company to apply simplified liquidation.

It can be assumed that it is easier to register a new company and start a new business than to rebuild an existing one. In the simplified liquidation, the founders do not need to appoint a liquidator. In essence, the company's simplified liquidation is free of charge to the founders of the company. The author believes that the impact of such a liquidation on the business environment has to be assessed. The simplified liquidation also can be used as an avoidance of insolvency proceedings.

It confirms that SRS role in organizing the business environment and tax authority impact on company's liquidation is significant.

² State Revenue Service of the Republic of Latvia. Information on Suspension of the Taxpayer's Economic Activities, 2012-2017. Available at <<https://www6.vid.gov.lv/SDA/List>>.

Conclusions

The SRS has the right to suspend the taxpayer's economic activities due to infringements of laws and regulations and renew it.

The SRS can impact on company's business directly or partly directly:

1. The direct impact is manifested as the right to terminate the taxpayer economic activities and give the information to the Register of Enterprises for making a decision on exclusion from the Commercial Register.
2. The partly direct impact is manifested as the right to exclude taxpayer from the VAT Payer Register, suspend the taxpayer's economic activity or to impose the additional fine, namely, deprivation of the right to take certain positions in commercial companies.

The regulatory framework gives the SRS possibility to inform the taxpayer about the possibility of suspension the taxpayer's economic activity. If the SRS warns the taxpayer of suspending its economic activity or has already suspended economic activity, the taxpayer has the opportunity to prevent irregularities and restore economic activity within a certain period of time.

The taxpayer has possibility to eliminate all the infringements and inform about it the SRS, and reinstate the economic activity.

If the taxpayer did not eliminate all the infringements and the SRS decided to suspend the economic activity of this taxpayer, the SRS send details on the suspension of economic activity of the taxpayer to the Enterprise Register if the economic activity of the taxpayer registered in the register of the Enterprise Register or Commercial Register and the taxpayer will be liquidated.

The regulation enables the taxpayer to remedy the deficiencies and restore the economic activity. But at the same time, this system can also be used for other purposes, for example, it can simplify the elimination of a business that could be beneficial in cases where a company has high liabilities to creditors and in this case, the company can avoid insolvency proceeding.

In 2012 the SRS decision on the suspensions of the taxpayer's economic activities was in 637 cases or the 0.23% of the total number of taxpayers in this year. In 2013 the SRS decision on the suspensions of the taxpayer's economic activities was for 3.40%, in 2014 – 3.30%, in 2015 – 3.63% and in 2016 – 2.99% of the total number of taxpayers in each particular year. In average it is 2.71% per year.

During 2012 – 2017 were registered 83121 entities and excluded 53645 entities in the Register of Enterprises. In the time period of 2012 till 2013 SRS suspended 50335 taxpayer's economic activities but renewing the economic activities only 4.93% of them.

The SRS role in organizing the business environment and tax authority impact on company's liquidation is significant.

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The article has been reviewed.

Received in October, 2018

Accepted in March, 2019

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